

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2009-326-C

IN RE:)
)
)
State Universal Service Support of Basic)
Local Service Included in a Bundled)
Service Offering or Contract Offering)
)

REPLY TESTIMONY

OF

JOSEPH GILLAN

ON BEHALF OF

SOUTH CAROLINA CABLE TELEVISION ASSOCIATION,
COMPSOUTH, TW TELECOM OF SOUTH CAROLINA LLC, AND
NUVOX COMMUNICATIONS INC.

Introduction

Q. Please state your name and business address.

A. My name is Joseph P. Gillan. My business address is Post Office Box 7498, Daytona Beach, Florida 32116.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the South Carolina Cable Television Association (“SCCTA”), Competitive Carriers of the South (“CompSouth”), tw telecom of South Carolina LLC (“tw telecom”), and NuVox Communications, Inc. (“NuVox”). I previously filed direct testimony on behalf of this same group.

Q. What is the purpose of your reply testimony?

A. The purpose of my reply testimony is to respond to the argument that it would be appropriate to provide companies a subsidy to offer deregulated service-packages (*i.e.*, bundles) under the claim – without a shred of financial or economic analysis – that such subsidies are necessary for “universal service.”

My reply testimony fundamentally rejects this view, for a simple and powerful reason: USF tax revenues are extracted from customers who also have a valid use for their money, whether it is as simple as another “night out” for the family, or the purchase of new equipment to make a business more efficient. The rural ILECs do not enjoy a “first-taker” entitlement to skim a subsidy off the telecommunication bills of others for any purpose they desire, merely because they are rural (or merely because they are carriers-of-last resort). There must be a *compelling* justification – consistent with South Carolina law – for the Commission to legitimately tax consumers and businesses

1 throughout the state to provide a subsidy to these carriers.

2 As I explain below, the testimony favoring the expansion of the subsidy to
3 bundles is not only not compelling, it fundamentally violates the statutory goals
4 authorizing the creation of the Universal Service Fund, as well as the Commission's prior
5 Orders implementing the existing Fund. The South Carolina General Assembly
6 authorized the creation of a Universal Service Fund – and, therefore, the imposition of a
7 universal service tax – for two, and *only* two, purposes: (1) ensuring the availability of
8 basic local exchange telephone service at affordable rates, and (2) assisting in the
9 alignment of prices and/or cost recovery with costs.¹ Expanding the subsidy to
10 deregulated bundles does nothing to ensure the availability of *basic* local exchange
11 service (if anything, it only increases the success of bundles, which is a commercial-
12 marketing objective, not a public-policy goal), and would further distort the relationship
13 between price and cost by fostering below-cost bundle prices in direct contradiction of
14 the statutory goal.

15 The Commission must protect the legitimacy of its universal service tax and Fund
16 by limiting the subsidy to the narrow purposes of the statute, not the commercial
17 purposes of the rural ILECs. The USF should not provide any subsidy to deregulated
18 bundles.

¹ S.C. Code Ann § 58-9-280(E).

1 **II. Responding To The Argument That**
2 **The USF Tax Should Support Deregulated Bundles**
3

4 **Q. What is the basic rationale offered by the rural incumbent telephone companies**
5 **(“RLECs”) for including deregulated bundles in the South Carolina Universal**
6 **Service Fund?**

7 **A. In general, the RLECs offer three justifications, as summarized by South Carolina**
8 **Telephone Coalition (“SCTC”) witness Keith Oliver:²**

9 * Including deregulated bundles is consistent with the way
10 that such services are treated today by the South Carolina
11 USF and federal USF;

12 * Including deregulated bundles furthers universal service
13 policy; and,

14 * Including deregulated bundles is in the public interest.³
15

16 I address each of these areas below.
17
18

19 **Q. Assuming that it is true that the SCTA companies today receive USF subsidy for**
20 **deregulated bundles, would that provide a justification for the practice?**

21 **A. No, not at all. The fundamental purpose of this proceeding is to determine whether a**
22 **subsidy should be provided to deregulated bundles, not whether the RLECs have received**
23 **such a subsidy in the past.⁴**

² The SCTC also sponsored the testimony of Glenn H. Brown. Mr. Brown’s testimony, however, largely duplicates the testimony of Mr. Oliver. To the extent that Mr. Brown introduces a unique perspective concerning cost modeling, that perspective is not tied to the structure and operation of the South Carolina USF system and is fundamentally irrelevant to the issues in this proceeding. As such, I separately respond to Mr. Brown’s testimony at the conclusion of my reply.

³ Direct Testimony on Keith Oliver on Behalf of the South Carolina Telephone Coalition (“Oliver Direct”) at 3.

Q. Does the statute permit deregulated services to be subsidized?

A. No, as I explained in my direct testimony,⁵ the South Carolina statute only contemplates a subsidy for regulated basic services where there is a maximum allowable rate:

The size of the USF shall be determined by the commission and shall be the sum of the difference, for each carrier of last resort, between its costs of providing basic local exchange services and the maximum amount it may charge for the services.

Monies in the USF shall be distributed to a carrier of last resort upon application and demonstration of the amount of the difference between its cost of providing basic local exchange services and the maximum amount it may charge for such services.⁶

As I understand the Commission's orders, the Commission followed the statute and never intended to create a fund that provided subsidies to deregulated services.

Q. Why do you argue that the Commission never intended that the existing USF would provide a subsidy to non-basic, deregulated services?

A. To begin, the SC USF fund has always included a distinction between lines that would qualify for a subsidy (eligible lines) and lines that would not:

The amount of High Cost Support is determined by multiplying the number of eligible lines by the per-line support available for such lines in the designated support service area.⁷

⁴ Notably, even though the SCTC lists among its three “reasons” that subsidy should be provided to deregulated bundles because that is how these services are treated today, it nevertheless recognizes that it is the Commission that should to decide the issue. (Oliver Direct at 5).

⁵ Direct Testimony of Joseph Gillan on Behalf of SCCTA, CompSouth, tw telecom & NuVox (“Gillan Direct”) at 5.

⁶ S.C. Code Ann. § 58-9-280(E)(4) and (5). (Emphasis Added).

⁷ Order Approving Final Documents and Vacating Order No. 2001-954, Public Service Commission of South Carolina Docket No. 97-239-C, Order No. 2001-996, October 10, 2001 (“*Final USF Order*”), Exhibit B at 3. (Emphasis Added).

1 Consistent with the statute, the Commission expressly limited support to basic
2 residential and single-line business service:

3 The high cost support component is calculated on a per-line basis for
4 residential and single-line business service, then summed over all such
5 lines in the designated state USF support area.⁸
6

7 There is not a single provision in existing orders that defines a bundled offering as an
8 eligible line. Rather, the Commission appears to have followed the statute by developing
9 a USF that is limited to the *only* two services – residential and single-line business
10 service – that the legislature authorized for a subsidy.⁹

11 **Q. Are bundles the *same* as basic residential or single-line business service, merely**
12 **because they may include (among other features and services) the same capabilities**
13 **as basic local service?**

14 A. No. To the contrary, the General Assembly expressly defined deregulated bundles as
15 having to be different than stand-alone service:

16 § 58-9-285(A)(1) “Bundled Offering” means:

17 (a) for a qualifying LEC, an offering of two or more products or
18 services to customers at a single price provided that:

19 (i) the bundled offering must be advertised and sold as a
20 bundled offering at rates, terms, or conditions that are
21 different than if the services are purchased separately from
22 the LEC's tariffed offerings;

23 By statute (as well as economics), bundled offerings must be different than the services
24 purchased individually in order to qualify for deregulation. Merely *sharing* some of the

⁸ *Final USF Order*, Exhibit A at 7. (Emphasis added).

⁹ *See*, for instance, definition of “basic local exchange telecommunications service” as being limited to service provided to “single-party residential and single-line business customers.” *Ibid* at 1.

1 capabilities of local service does not make the bundle the *same* as basic local service; it
2 must be different in order to even qualify as a bundle.

3 **Q. Do the Commission's existing rules affirmatively *prohibit* providing a subsidy to**
4 **bundles that include non-telecommunications components (such as video or internet**
5 **access)?**

6 A. Yes. The Commission's rules expressly prohibit subsidies from being used to support
7 non-telecommunications services (which would include video service and internet
8 access):

9 Non-telecommunications services shall not be supported by the
10 USF, nor will revenues received from non-telecommunications
11 services be used to support USF.¹⁰
12

13 A bundle is a (by definition) the offering of multiple services at a single price. As such, it
14 is a mathematical impossibility to determine which services in the bundle (if any) are
15 being supported by a subsidy because none of the services have a unique price.
16 Consequently, the Commission's prohibition against providing a subsidy to non-
17 telecommunications services can only be satisfied if it excludes bundled offerings
18 (certainly those with non-telecommunications services) from the fund.¹¹

19 Moreover, in the Commission's initial *USF Guidelines Order*, the Commission
20 made clear that it would only provide support to services mandated by federal and state
21 law:

¹⁰ *Ibid* at 8. (Emphasis added).

¹¹ As SCTC witness Oliver acknowledges, many bundles include non-telecommunications services (Oliver Direct at 15, emphasis added):

Again, for marketing purposes, bundling may also involve both telecommunications and non-telecommunications services, such as high-speed internet, cable/video, home security, etc.

1 We hold that the services to be funded are all services mandated by the
2 FCC and South Carolina State Law.¹²

3
4 Deregulated bundled offerings are entirely voluntary and, as such, would not satisfy the
5 Commission's holding that the only services to be funded by the South Carolina USF
6 would be services mandated by law.

7 **Q. Does the Statute contemplate requests to expand support to more than basic**
8 **residential and single-line business services?**

9 A. Yes, the statute (and Commission's implementing orders) include an explicit process for
10 a carrier to *ask* the Commission to expand the services that are eligible for support:

11 After Notice and an opportunity for a hearing to all affected carriers, the
12 Commission by rule may expand the set of basic local exchange
13 telecommunications services within the definition of universal services...¹³

14
15 None of the SCTC testimony ever points to a Commission decision – after notice and
16 hearing – expanding the Fund to include deregulated bundles.

17 **Q. Has prior SCTC testimony recognized that only basic residential and single-line**
18 **business service would qualify for subsidies?**

19 A. Yes. In prior proceedings, the SCTC understood that only basic residential and single-
20 line business lines exchange service would receive subsidies. As Mr. Oliver once
21 explained:

¹² Order Addressing the Universal Service Fund, Public Service Commission of South Carolina
Docket No. 97-239-C, Order No. 97-753, September 3, 1997 ("*USF Guidelines Order*") at 14. (Emphasis
added).

¹³ *Final USF Order*, Exhibit A at 1 and South Carolina Code § 58-9-280(E)(8).

1 We have to understand the purpose of Universal Service is to support the basic
2 local exchange rates, which are defined as R1 and B1.¹⁴

3 ***

4 “According to Oliver, the proposed [SCTA] plan is a means to continue to
5 protect affordable basic local telephone service in South Carolina.”¹⁵

6
7 Prior testimony by the SCTA understood the necessary linkage between the subsidy and
8 the price of basic local service. This linkage, however, is totally abandoned here, with
9 the SCTC now claiming that there should be no linkage between the subsidy provided to
10 the RLEC and the services (much less the prices) that the RLEC offers:

11 Thus, the maximum amount that a company can charge for basic local
12 service, while being relevant to the calculation of the theoretical maximum
13 amount a company could request, has no real bearing on actual State USF
14 distributions. Actual distributions represent a dollar-for-dollar (revenue-
15 neutral) replacement of the amount of revenue that is lost when a rate that
16 contains implicit support is reduced.¹⁶

17
18 So here lies the truth. In the SCTC’s own words, the maximum rate for basic local
19 service has no bearing on the level of public subsidy the USF tax provides an RLEC.
20 Rather, according to the SCTC, the USF is a revenue-in-perpetuity fund, allowing the
21 RLECs to reduce some rates without experiencing lower revenues. Even as a revenue-
22 based fund, however, the USF lacks balance because *increasing* revenues from the sale of
23 additional services never results in a lower subsidy. The USF is simply a “best-of-all-
24 worlds” fund (at least from the perspective of the RLEC, but not those that must provide
25 the subsidy).

¹⁴ July 19, 2000, Hearing Transcript of *In re: Proceeding to Establish Guidelines for an Intrastate Universal Service Fund*, Oliver Testimony, p. 458, lines 5-7.

¹⁵ Order on Universal Service Funds, Public Service Commission of South Carolina Docket No. 97-239-C, Order No. 2001-419, June 6, 2001 (“*SC USF Phase-In Order*”) at 6. (Emphasis added).

¹⁶ Oliver Direct at 13. (Emphasis added).

1 **Q. Do you believe that the South Carolina *Commission* ever intended that the USF fund**
2 **should be a revenue-in-perpetuity fund as now described by the SCTA?**

3 A. No. It is clear that the Commission was focused on a very *different* objective than
4 guaranteeing revenues for incumbents. Indeed, the Commission explicitly rejected such
5 an arrangement:

6 We likewise reject the argument that the State USF will provide ILECs
7 with a guaranteed level of earnings -- in effect, some kind of insurance
8 against competitive loss.¹⁷
9

10 As described by the SCTC, the amount of USF support today has *nothing* to do with
11 either the rates or costs of basic local service. Disbursements are based *solely* on
12 sustaining forever the revenue “lost” when an access charge reduction was implemented
13 years ago, even though in the intervening years many customers now subscribe to
14 unlimited calling plans that make no distinction between interstate and intrastate toll
15 (and, therefore, are indifferent to intrastate access charges), or make toll calls from their
16 cell phone (where pricing has long ignored the intrastate/interstate distinction).

17 Contrast the SCTC’s revenue-in-perpetuity interpretation of the USF with the
18 stated intention of the South Carolina Commission to establish a fund that:

19 * Provided support *only* to residential and single-line business
20 service,¹⁸
21

22 * Provided support *only* to services mandated by the FCC and South
23 Carolina State Law.¹⁹
24

25 * *Prohibited* support to non-telecommunications services;²⁰
26 and,

¹⁷ SC USF Phase-In Order at 43.

¹⁸ Final USF Order, Exhibit A at 7.

¹⁹ USF Guidelines Order at 14.

* Assured parties that the supported services would only be expanded after Notice and opportunity for hearing. ...²¹

Given the clear intention of the Commission that the USF be focused on affordable rates for basic local service to residential and single-line businesses that are mandated by law – and that *no* subsidy be provided for non-telecommunication services, and that the subsidy not be expanded to other services without notice and hearing – the SCTC’s admission that the USF provides subsidy today should be harshly rejected as justification for continuing the practice.²²

Q. The SCTC (and others)²³ also claim that subsidies should be provided to deregulated bundles because such treatment would be “consistent” with how the federal fund operates. Is this claim accurate?

A. No -- the FCC has never even addressed the question as to whether deregulated bundles (which largely did not exist when the federal system was developed) should receive support. Thus, the suggestion that the South Carolina Commission should look to the FCC for guidance requires that this Commission interpret federal *silence* on a question never raised as a finding of intent.

The ORS testimony (regarding the alleged consistency with federal policy) is particularly disappointing in this regard, as it makes citation to an FCC order that is better

²⁰ *Final USF Order*, Exhibit A at 8.

²¹ *Ibid* at 1 and South Carolina Code § 58-9-280(E)(8).

²² My testimony focuses on the appropriate treatment of bundles going forward and does not address whether the Commission should require reimbursement to the USF for subsidies received in the past.

²³ See Direct Testimony of Dawn M. Hipp on behalf of the Office of Regulatory Staff (“*Hipp Direct*”) at 4, and Direct Testimony of William F. Kreutz on behalf of Windstream (“*Kreutz Direct*”) at 7.

1 read as *contradicting* the ORS position.²⁴ Specifically, the ORS cites an FCC decision to
2 *not* expand support to broadband services, noting that “the network is an integrated
3 facility that may be used to provide both supported and non-supported services.”²⁵ This
4 statement by the FCC contradicts the ORS testimony by rejecting suggestions that
5 broadband service (which is frequently part of a bundle) be included for support, even
6 though the FCC recognized that the network itself would continue to be used to provide
7 such non-supported services. Elsewhere in the same decision, the FCC rejected
8 suggestions to include unlimited *local* calling as a supported service,²⁶ and rejected
9 including toll service at all (much less the unlimited toll calling that is a frequent
10 component of many bundles).²⁷ Overall, the FCC Order emphasizes the need to
11 *narrowly* provide subsidies only to targeted services (recognizing that a subsidy imposes
12 a cost on others);²⁸ there is nothing in the decision that suggests, implies or reasonably
13 infers that the FCC would endorse providing a subsidy to deregulated services.

14 In summary, the argument that support should be provided for deregulated
15 bundles because “that’s the way the FCC does it” ignores the fact that the FCC has never
16 *directly* addressed that issue, but where it has addressed comparable questions, the FCC
17 has rejected calls to expand the subsidy to additional services.

²⁴ The SCTA did not cite to any FCC Order, presumably aware that no such authority existed.

²⁵ Order and Order on Reconsideration, Federal Communications Commission CC Docket No. 96-45 at ¶ 13 (rel. July 14, 2003) (“*FCC Reconsideration Decision*”). (Emphasis Added).

²⁶ *FCC Reconsideration Decision* at ¶ 14.

²⁷ *Ibid* at ¶ 25.

²⁸ *Ibid* at ¶ 7 finding: “[T]hat the public interest would not be served by expanding the list of supported services We agree with the Joint Board that the current list of supported services strikes the right balance between ensuring the availability of fundamental telecommunications services to all Americans and maintaining a sustainable universal service fund.

1 **III. Expanding Support For Deregulated Services Is Not In The Public Interest**

2
3 **Q. What are the basic “public interest” reasons being offered to justify expanding the**
4 **USF to provide subsidy to deregulated bundles?**

5 A. The (alleged) public interest justifications are two-fold:

- 6 1. That without a subsidy, there would be a possible reduction in the
7 number of bundles offered to rural consumers,²⁹ and
8 2. That unless the RLEC has a subsidy (that its competitor does not),
9 the RLEC will be competitively disadvantaged.³⁰

10 Importantly, these justifications are far removed from the goal of universal service, which
11 is clearly limited to the offering of basic local service at affordable rates,³¹ not to make
12 sure that deregulated bundles are profitable to RLECs, or to improve their competitive
13 position. Consequently, as a *threshold* matter, the basic argument that deregulated
14 bundles should be subsidized violates the enabling statute that was explicit that the
15 subsidy is only intended to cover basic residential and single-line business service.

16 **Q. Would it be sound public policy to subsidize deregulated bundles?**

17 A. No. As indicated at the outset of my testimony, every dollar of subsidy provided to an
18 RLEC is first *taken* from someone else, either a family or business in the State. It is not
19 enough to claim that the subsidy is desired, or that prices for bundles may be higher
20 without a subsidy – the RLECs must explain why there should a public duty for one

²⁹ See Oliver Direct at 25; Hipp Direct at 5, Kreutz Direct at 5.

³⁰ See Hipp Direct at 6.

³¹ South Carolina Statute § 58-9-10(16): The term "universal service" means the providing of basic local exchange telephone service, at affordable rates, upon reasonable request, to all residential and single-line business customers within a defined service area.

1 neighbor (whose services are not subsidized) to pay for the services of another (that
2 receives a subsidy).

3 The USF is funded by a *tax* – and, like any tax, there needs to be a compelling
4 reason to use the force of government to separate a wage earner from its wages, or a
5 business owner from its revenue. Keeping RLECs “competitive,” or making bundles
6 “cheaper,” may sound compelling to the RLEC, but how would the Commission explain
7 it to the South Carolinians that are footing the bill? It is one thing to claim that a phone
8 network with only one phone has no value³² – it is quite another to claim that every
9 citizen in South Carolina benefits (and, therefore, should pay) to make certain that others
10 may enjoy the option of a “service-bundle” without having to fully pay for it.

11 **Q. Would subsidizing bundles increase the penetration of phone service – that is, would**
12 **it increase *universal service*?**

13 A. No. I do not commonly quote ILECs when it comes to questions of public policy, but on
14 this issue Verizon recently expressed the point concisely when addressing the related
15 question as to whether Lifeline discounts should apply to bundles:

16 As a matter of public policy, moreover, the [Florida] Commission should
17 not require a Lifeline discount on bundles. The underlying public policy
18 goal of the Lifeline and Linkup programs is the “preservation and
19 advancement of universal service.” Mandating Lifeline discounts for
20 bundles would not increase subscribership because its principal effects
21 would be to encourage Lifeline customers who already have basic service
22 to upgrade to nonbasic Service packages In other words, the mandate
23 would not increase network subscribership, but would merely provide a

³² Oliver Direct at 7:

[O]ne phone does no one any good. You might fully enjoy electricity at your home, even if none of your neighbors have it. The same could be said for water or cable TV. But, if you had the best phone service in the world, and no one else had phones, it would be worthless.

1 Lifeline discount to additional customers who already have telephone
2 service. Such a requirement would not advance universal service.³³

3
4 Similarly, providing USF subsidies to bundles would do nothing to increase universal
5 service in South Carolina (nor do any of the SCTC witnesses actually claim that it
6 would). Rather, expanding the subsidy to bundles would simply increase the penetration
7 of bundles, not increase subscribership to basic local service. Increasing the number of
8 bundles, however, is *not* universal service, no matter how much the SCTC would like the
9 Commission to believe that it is.

10 **Q. But isn't one of the goals for the South Carolina USF to make sure that the rates**
11 **and services in rural areas are comparable to other areas of the state?**

12 A. No. It would appear that the SCTC is not satisfied with South Carolina law as written, so
13 they have added a provision. Compare the following *description* of South Carolina law
14 to the actual *statute* (even as cited by the witness):

15 [T]here are two parts to universal service. First, the network must be built
16 out, even to high-cost areas. Second, even where costs are high,
17 subscribers should not be charged rates higher than those charged to
18 subscribers in urban or lower-cost areas. South Carolina law defines
19 universal service as “the providing of basic local exchange telephone
20 service, at affordable rates, upon reasonable request, to all residential and
21 single-line business customers within a defined service area.”³⁴

22
23 As the statutory citation included by the SCTA makes clear, the goal of universal service
24 is only that the rates for basic local exchange service remain affordable – a standard that
25 does not require that rates be the same across the state (even for basic local exchange
26 service), much less require that the rates for *all* services be comparable everywhere.

³³ Verizon Florida LLC's Post-Hearing Brief, Florida Public Service Commission Docket No. 080234-TP, April 3, 2009 at 2 (footnotes omitted/emphasis added).

³⁴ Oliver Direct at 6, citing S.C. Code Ann. § 58-9-10(16). (Emphasis added).

1 **Q. Would providing subsidies for bundles distort competition?**

2 A. Yes. But before I explain, let me make clear that the competitive effect (while important
3 to the companies sponsoring my testimony) is *not* the principal policy reason the
4 Commission should reject expanding the subsidy to deregulated bundles. The primary
5 reason is that there is no net benefit to consumers or businesses by increasing the USF tax
6 throughout the state to (allegedly) lower bundle prices in some areas.

7 At *best*, expanding USF subsidy to bundles would merely shift revenues collected
8 from one group (paying the USF Tax) to another group (subscribers to bundles), with no
9 net benefit. At *worst*, some (or all) of the subsidy would be diverted to the pockets of the
10 rural ILECs, with only a portion flowing through to consumers, and the Commission
11 would have no mechanism to tell how much. Any reduction in the bundle price *greater*
12 than the subsidy would occur only as a result of competitive pressure – which means that
13 the resulting lower price would likely occur with or without the subsidy, in which case it
14 is unneeded.

15 **Q. How would the subsidy distort competition?**

16 A. The RLECs' own testimony explains that they seek the subsidy to improve their
17 competitive position by offering lower prices:

18 The purpose of a bundle is to offer consumers a benefit over purchasing
19 services at stand-alone prices.³⁵

20 ***

21 Bundles offer customers a convenient package of services at prices lower
22 than they would pay for individual stand-alone services.³⁶
23

³⁵ Kreutz Direct at 7.

³⁶ Oliver Direct at 16.

1 All things being equal, lower prices are to be encouraged – but there is no “all things
2 being equal” under the RLEC proposal to subsidize bundles. These are not lower prices
3 from greater efficiency or a willingness to accept lower profits; these are lower prices that
4 result solely from the customers in other parts of the state being forced to pay higher
5 prices (i.e., through the USF tax) to provide the subsidy. Not only is this result
6 unnecessary for universal service (which is not defined by increasing the penetration of
7 bundles), it is directly contrary to the statutory goal of the USF to “assist with the
8 alignment of prices and/or cost recovery with costs.”³⁷

9 The RLECs apparently cannot comprehend that in a market economy,
10 competition is supposed to be based on cost-based comparisons to alternatives:

11 If an RLEC is forced to charge higher rates for competitive services
12 simply to help pay for the network, it creates a competitive disadvantage
13 for the RLEC and deprives customers of the benefits of true competition.³⁸
14

15 True competition should occur in the absence of any subsidy. The USF is an exception to
16 the normal way markets operate, because of a public policy that is limited (by the General
17 Assembly and the Commission’s implementing decisions) to basic residential and single-
18 line service. Expanding this “exception” to deregulated bundles frustrates competition, it
19 does not promote it.

20 **Q. Finally, the SCTC also sponsored the testimony of Mr. Brown.³⁹ Do you have a**
21 **response to this testimony?**

22 **A.** Yes. Generally, Mr. Brown’s testimony repeats various claims that are also included in

³⁷ S.C. Code Ann. § 58-9-280(E).

³⁸ Oliver Direct at 22.

³⁹ Direct Testimony of Glenn H. Brown on behalf of the South Carolina Telephone Coalition (“Brown Direct”).

1 the testimony of Mr. Oliver, although recast in the context of universal service as a
2 generic issue (*i.e.*, not specific to facts relevant to South Carolina). For instance, Mr.
3 Brown claims (like Mr. Oliver):

4 The purpose of universal service funding is to ensure that consumers
5 living in high-cost areas have services reasonably comparable to those
6 available in urban areas, at reasonably comparable rates.⁴⁰
7

8 Although *federal* universal service policy does include rate comparability, the South
9 Carolina General Assembly has never authorized using the USF tax to equalize rates
10 between different areas of the State. Rather, as I explained earlier, the policy of South
11 Carolina is only to ensure that basic local service rates for certain customers (residential
12 and single-line business) remain affordable, which does not require that they be equal
13 everywhere, or that all services are offered everywhere. To the extent that Mr. Brown's
14 testimony parallels the testimony of Mr. Oliver, I do not repeat my rebuttal here.

15 **Q. Is there any area where Mr. Brown's testimony introduces a concept not included in**
16 **Mr. Oliver's testimony?**

17 A. Yes. Mr. Brown's testimony includes a discussion that, in summary form, argues that
18 RLECs incur higher costs outside the towns they serve than within them, principally
19 because the line density is lower outside a community than within it.⁴¹

20 **Q. Is this discussion relevant to this proceeding?**

21 A. No. First, it is certainly logical that the "from scratch" (also known as forward-looking)
22 cost to construct a network (which is what the BCPM discussed by Mr. Brown estimates)
23 is lower within a town than beyond it (on a per-line basis). Importantly, however, the

⁴⁰ Brown Direct at 14.

⁴¹ Brown Direct at 12-14 and 16-19.

1 USF cost studies used for rural carriers in South Carolina are *not* based on an estimate of
2 the forward-looking cost to construct the network, but rather are based on the *embedded*
3 (or accounting) cost of the network.⁴²

4 Significantly, accounting costs are not only influenced by the initial cost to
5 construct a network, but are greatly affected (because of accumulated depreciation) by
6 the time-since-construction. That is, over time, as capital costs are recovered, the
7 embedded cost of plant becomes less and less.

8 **Q. Is it true that the *embedded* cost per line is necessarily higher in outlying areas than**
9 **in a town?**

10 A. No, it is not. It is entirely possible that areas that experience relatively slow growth rates
11 – which would mean that the average age of the investment is relatively old – can exhibit
12 lower embedded costs, even if the initial cost is higher, because there are greater levels of
13 accumulated depreciation. Importantly, there are no studies in this docket that have
14 attempted to determine whether the *embedded* cost of the RLECs telephone plant – which
15 is the cost basis used by the RLECs for USF in South Carolina – is lower (or higher)
16 based on customer density once the effect of accumulated depreciation is considered.
17 Mr. Brown’s testimony concerns a cost-measure not used by the RLECs in South
18 Carolina and, as such, it cannot be used to draw any relevant conclusion regarding the
19 issues in this proceeding. For instance, Mr. Brown alleges that:

⁴² Order on Universal Service Cost Models, Public Service Commission of South Carolina Docket
No. 97-239-C, Order No. 98-322, May 6, 1998 (“*SC Cost Model Order*”) at 68.

1 The COLR receives support only because of the actual cost of serving the
2 high-cost customers that the competitor has chosen not to serve. If the
3 COLR did not serve any high-cost customers then it would not receive any
4 high-cost support either. Universal service funding in no way disrupts or
5 alters the competitive dynamic for customers in the lower-cost areas of the
6 COLR's service territory.⁴³

7
8 This statement is simply not true. There are not now – and never have been – any cost
9 studies in South Carolina's various proceedings used to determine the relative cost of
10 *different* areas in the RLEC's service for purposes of the USF. To the contrary, as
11 explained by Mr. Oliver, even the embedded cost studies used in earlier phases "bear no
12 relation" to actual USF disbursements, which are calculated on the basis of an access
13 charge reduction several years ago.⁴⁴ Consequently, there is no such thing as "the lower-
14 cost areas of the COLRs service territory," any more than there are "high-cost customers
15 that the competitor has chosen not to serve." The entire analysis is fiction.

16 Similarly, and in direct contradiction of the manner in which the South Carolina
17 USF operates, Mr. Brown concludes:

18 In other words, the customers living in cities and towns neither need nor
19 receive SCUSF support.⁴⁵

20
21 It may well be that the customers in the cities and towns served by RLECs do not need
22 any USF subsidies, but the USF fund itself makes no distinction whatsoever in its
23 disbursements between the customers in these parts of the RLECs territory and the
24 customers located beyond.

⁴³ Brown Direct at 20.

⁴⁴ Oliver Direct at 13.

⁴⁵ Brown Direct at 14.

1 Consequently, because Mr. Brown's testimony is not grounded in how the South
2 Carolina program was designed or operates, his conclusions have no relevance.

3 **Q. Does this conclude your rebuttal testimony?**

4 **A. Yes.**